

“Use” does not include the exercise of right or power over electricity for the generation, production, transmission, distribution, delivery or sale of electricity in the regular course of business or the use of electricity for such purposes. See 35 ILCS 640/2-3. (This is a PLR).

August 5, 2002

Dear Xxxxx:

This Private Letter Ruling, issued pursuant to 2 Ill. Adm. Code 1200 (see <http://www.revenue.state.il.us/legalinformation/regs/part1200>), is in response to your letter of February 7, 2002 and subsequent discussions we had during a meeting held on April 24, 2002. Review of your request for a Private Letter Ruling disclosed that all information described in paragraphs 1 through 8 of subsection (b) of Section 1200.110 appears to be contained in your request. This Private Letter Ruling will bind the Department only with respect to TAXPAYER for the issue or issues presented in this ruling. Issuance of this ruling is conditioned upon the understanding that neither TAXPAYER nor a related taxpayer is currently under audit or involved in litigation concerning the issues that are the subject of this ruling request.

In your letter, you have stated and made inquiry as follows:

On behalf of TAXPAYER (‘Taxpayer’), we respectfully request a Private Letter Ruling from the Illinois Department of Revenue (the ‘Department’) pursuant to 2 Ill. Adm. Code 1200.110. Each of the requested rulings relates to the Electricity Excise Tax (‘EET’) imposed by 35 ILCS 640/1 et seq.

As explained in more detail below, Taxpayer requests that the Department issue a private letter ruling indicating the following:

1. No EET is imposed on Taxpayer with respect to electricity lost to resistance and heat within the transmission and distribution system or electricity used by Taxpayer at substations and other system facilities within the transmission and distribution system; these circumstances are referred to herein as ‘system loss.’
2. No EET is imposed on Taxpayer with respect to electricity used by Taxpayer at its administrative offices, technical or engineering facilities, and other locations outside the transmission and distribution system; these circumstances are referred to herein as ‘non-system use.’

Statement of Facts

Taxpayer is an Illinois corporation with its principal place of business at ADDRESS. Taxpayer is a public utility within the meaning of Section 3-105 of the Public Utilities Act,

220 ILCS 5/1-101, et seq., in that it is engaged in the transmission, distribution, sale, delivery, and furnishing of electricity in the State of Illinois.

Basics of Power Delivery. Generally, an electric power system is composed of three elements: generation, transmission, and distribution. Electricity is produced at a generating station. Substations adjacent to the generating station prepare the power for transmission by increasing, or 'stepping up,' the voltage, generally to between 138 and 765 kilovolts depending on the distance to be traveled and the amount of electricity to be delivered. The electricity is then delivered to the transmission provider and travels from the substation along transmission lines to substations located in the area where the power will be used or, if it is to be sold elsewhere, to interconnections with neighboring systems. Once the electricity reaches the area where it will be used or consumed, the voltage is decreased, or 'stepped down,' at a substation and carried by the delivering supplier along local distribution lines. Typically, these lines range in voltage from 4,000 to 34,000 volts. Once the power reaches the immediate area or building where it will be delivered to consumers, the voltage is, in most cases, further decreased by distribution transformers to a voltage which can safely be used by consumers (between 120 and 2,400 volts). In some cases, this low-voltage electricity will travel along secondary distribution lines a very short distance until it reaches the end user. Along with these lines and substations, utilities maintain communication and relaying systems to promote the safe and reliable operation of the grid. This network of transmission lines, distribution lines, substations, and associated equipment is referred to as the 'transmission and distribution system' or the 'T&D system.'

Taxpayer owns and manages the T&D system used to transport electricity from generating stations to homes and businesses in Illinois. Taxpayer purchases electricity in wholesale transactions from various generating companies and delivers it as described above to electricity consumers.

System Losses. A portion of the electricity that enters the T&D system from a generating station is lost in the transmission of power from the generating plant to the end user. This loss is referred to as 'line loss' or 'system loss.' Line loss is a function of resistance in the material used to conduct electricity. Temperature and the current at which electricity passes through the T&D system are variables that can increase or decrease the amount of line loss.

A portion of the electricity that enters the T&D system from a generating station is used by the T&D system in the delivery of power. This use is also referred to as 'system loss.' For example, many substations are equipped with buildings that shelter equipment used to increase or decrease the voltage of electricity passing through the substation. Such buildings are generally equipped with interior and exterior lights (and may be heated) in order to facilitate repair and inspection of the equipment. Electricity used at the substation or other system facilities for light, heat, and the operation of system equipment is drawn directly from the T&D system and is not metered.

Non-System Use. A portion of the electricity acquired for resale in a wholesale transaction by Taxpayer from generating stations is used by Taxpayer at its administrative offices, technical research facilities, and other locations outside the transmission and distribution system. For example, Taxpayer operates administrative offices located at ADDRESS. These offices use electricity delivered by the T&D system.

Applicable Law

Prior to August 1, 1998, public utilities engaged in the business of supplying electricity were required to pay tax imposed by the Public Utilities Revenue Act (35 ILCS 620/1 et seq.), referred to as the 'PUR Tax.' In 1997, the PUR Tax was repealed with the enactment of the Electric Service Customer Choice and Rate Relief Law of 1997 (the 'Restructuring Legislation'). The Restructuring Legislation enacted the Electricity Excise Tax Law (the 'Act') which imposes the EET, effective August 1, 1998.

The Act imposes the EET on 'the privilege of using in this State electricity purchased for use or consumption and not for resale.' 35 ILCS 640/2-4(a). The EET is imposed at graduated rates based on the number of kilowatt-hours delivered to a purchaser and used or consumed each month. 35 ILCS 640/2-4(a). The term 'purchaser' is defined in the Act as 'any person who acquires electricity for use or consumption and not for resale, for a valuable consideration.' 35 ILCS 640/2-3(e). The term 'use' is defined in the Act as 'the exercise by any person of any right or power over electricity incident to the ownership of that electricity, except that it does not include the generation, production, transmission, distribution, delivery or sale of electricity in the regular course of business or the use of electricity for such purpose.' 35 ILCS 640/2-3(k).

The EET is required to be collected from a purchaser by 'any delivering supplier maintaining a place of business in this State.' 35 ILCS 640/2-7. 'Delivering supplier' is defined in the Act as 'any person engaged in the business of delivering electricity to persons for use or consumption and not for resale.' 35 ILCS 640/2-3(i). Delivering suppliers are required to collect EET with respect to electricity delivered 'to or for the purchaser .' 35 ILCS 620/2-7.

Taxpayer is a 'delivering supplier' within the meaning of the Act and, accordingly, is required to collect the EET from 'purchasers' that 'use' electricity within the meaning of the Act.

Rulings No. 1 & 2

Taxpayer requests that the Department issue a private letter ruling indicating that (1) no EET is imposed with respect to electricity lost to 'system loss,' and (2) no EET is imposed with respect to electricity used by Taxpayer as 'non-system use.'

No EET should be imposed with respect to these transactions because Taxpayer is not a 'user' of electricity within the meaning of the EET. As discussed above, the term 'use' is defined for purposes of the EET to exclude 'the generation, production, transmission, distribution, delivery or sale of electricity in the regular course of business or the use of electricity for such purposes.' 35 ILCS 640/2-3(k). Thus, the 'use' of electricity in the 'transmission, distribution [and] delivery' of electricity is not subject to tax.

Electricity lost to system loss is not 'used' within the meaning of the EET because it is consumed as part of the transmission and distribution of electricity. Hence, no EET should be imposed with respect to electricity lost to system loss.

Similarly, electricity consumed via 'non-system use' is used in the transmission and distribution of electricity. This electricity enables Taxpayer to operate its administrative, research, and development facilities, all of which are essential to Taxpayer's ability to

transmit and distribute electricity. Thus, Taxpayer's 'non-system use' of electricity is not a taxable 'use' of electricity under the Act.

This conclusion is consistent with the holding of the Illinois Appellate Court in *American Stores Company v. Department of Revenue*, 296 Ill. App. 3d 295 (1st Dist. 1998) ('*American Stores*'). At issue in *American Stores* was section 2-201(g)(3) of the Illinois Income Tax Act ('IITA'), which permitted taxpayers an investment tax credit ('ITC') against income tax for 'investment in qualified property .' *Id* at 297. 'Qualified property' was defined as 'property which...is used in Illinois by the taxpayer in...retailing.' *Id*. The taxpayer claimed ITCs for investment in buildings, machinery, and other equipment acquired and placed in service in its Illinois retail operations, including store equipment used both on and off the retail selling floor, warehouses and related equipment, transportation facilities and related equipment, and general office equipment. See *id*.

The Department disallowed the ITCs for all property except that used on the retail selling floor, ruling that the remaining property was not 'used' in 'retailing,' as required by the IITA. See *id*. The Department argued that the term 'property used in retailing' was intended to refer only to property actually used on the retail selling floor and could not be expanded to include all property used in support of retailing. *Id*. The taxpayer contended that this term encompassed the 'machinery, equipment, and offices used to carry out functions such as accounting, purchasing, risk management, marketing strategies, personnel functions, and legal matters,' which the taxpayer asserted were 'essential parts of the retailing business.' *Id*.

The Court employed various principles of statutory construction to ascertain the legislature's intent in enacting the ITC. See *id*. The Court found that neither the plain language of section 2-201(g) nor its legislative history supported the distinction advocated by the Department between equipment located at the retail site and that located elsewhere. See *id*. at 300. Furthermore, the Court found no limiting language within the statute allowing ITCs only for qualified property located at retail sites. See *id*.

Instead, the Court found that the legislature intended a more expansive reading of the term 'retailing,' including not only 'property used in 'the sale of tangible property,' but also property used to perform' services rendered in conjunction with the sale of tangible consumer goods or commodities." *Id*. The court also noted that the legislature's use of such language 'demonstrates...[its] intention that qualified property used 'in retailing' includes any property used by a retailer to obtain and complete a retail sale, or to perform services in conjunction with the completion of such a sale.' *Id*.

The plain language of the Act excluding 'the generation, production, transmission, distribution, delivery or sale of electricity in the regular course of business or the use of electricity for such purposes' from the EET's definition of 'use' is entitled to a similarly broad reading. Just as the Illinois Appellate Court found that property used in American's back-office operations was eligible for the ITC, electricity used in any facet of generating, producing, transmitting, distributing, delivering, or selling electricity, whether at a substation or an administrative office, should be excluded from the definition of 'use' under the Electricity Excise Tax Law.

Therefore, Taxpayer requests that the Department issue a private letter ruling to Taxpayer indicating that (1) no EET is imposed with respect to electricity lost to

resistance and heat within the transmission and distribution system or electricity used by Taxpayer at substations and other system facilities within the transmission and distribution system, and (2) no EET is imposed with respect to electricity used by Taxpayer as non-system use.

Procedural Statements

The Illinois Department of Revenue is currently conducting an audit of Taxpayer covering the period January 1997 through December 2000. The Department's audit covers both the EET and the Public Utilities Revenue Tax imposed on Taxpayer for periods prior to August 1, 1998. The issues presented by this ruling request are not being examined in an audit of Taxpayer or any of its subsidiaries, nor are the issues addressed by pending litigation involving Taxpayer, any of its subsidiaries, or any related taxpayers. Additionally, Taxpayer has not found any Illinois case law or regulations that are dispositive of the requested rulings.

To the best of Taxpayer's knowledge, the Department has not previously ruled on the same or similar issues for Taxpayer or any of its subsidiaries or predecessors under the EET. Additionally, to the best of the Taxpayer's knowledge, neither the Taxpayer nor any of its subsidiaries have previously submitted the same or similar issues to the Department for determination, withdrawing it before a letter ruling could be issued. Furthermore, the Taxpayer has not located any authorities contrary to the requested rulings.

Any further information required by the Department may be obtained by calling PERSON.

Attached is a power of attorney authorizing the undersigned counsel to act on behalf of Taxpayer in filing this request for a ruling. The undersigned counsel declares that he is not currently under suspension or disbarment from practice before the Department and is a member in good standing of the bar of the State of Illinois.

Request for Conference

Taxpayer respectfully requests a post-submission conference with a representative of the Department to allow Taxpayer the opportunity to answer any questions the Department may have, and to allow the Department to obtain any additional information it requires regarding the rulings requested by Taxpayer.

In regards to your first issue, the Department agrees that no Electricity Excise Tax is incurred upon electricity lost within the transmission and distribution system. System losses do not constitute electricity that is purchased for use or consumption.

In regards to your second issue, the Department agrees that no Electricity Excise Tax is incurred upon electricity used at administrative offices, technical or engineering facilities and other locations outside the transmission and distribution system by a delivery supplier. This is due to the definition of the term "use" in the Law. "Use" does not include the exercise of right or power over electricity for the generation, production, transmission, distribution, delivery or sale of electricity in the regular course of business or the use of electricity for such purposes. See 35 ILCS 640/2-3. In the case where a delivering supplier uses electricity in its administrative offices, technical or engineering

facilities and other locations outside the transmission and distribution system, the electricity is being used for the sale of electricity.

The facts upon which this ruling are based are subject to review by the Department during the course of any audit, investigation, or hearing and this ruling shall bind the Department only if the material facts as recited in this ruling are correct and complete. This ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material facts recited in this ruling.

I hope this information is helpful. If you have further questions concerning this Private Letter Ruling, you may contact me at (217) 782-2844. If you have further questions related to the Illinois sales tax laws, please visit our website at www.revenue.state.il.us or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Melanie A. Jarvis
Associate Counsel

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